The SAFE Banking Act

Ending welfare for Wall Street Megabanks

Senator Sherrod Brown
Chairman
Subcommittee on Financial Institutions and Consumer Protection
United States Senate Committee on Banking, Housing, and Urban Affairs

I. Introduction

Two years ago – after the worst financial crisis in over a half century – one-third of the United States Senate voted cut "Too Big to Fail" Wall Street megabanks down to size. As I said at the time, "Too big to fail is simply too big."[1]

In 2010, my former colleague Ted Kaufman (D-Del.) and I introduced the Safe, Accountable, Fair and Efficient (SAFE) Banking Act, to restrict the amount of debt that a single financial company could take on relative to the U.S. economy. The goal was to constrain excessive financial sector debt and risk-taking and eliminate the taxpayer support enjoyed by the largest megabanks.

Today, I am proud to re-introduce that legislation, and to provide the following report outlining the case for restructuring our largest Wall Street megabanks in order to eliminate the special government support that they continue to enjoy.

II. The United States Government Supports Too Big To Fail Banks

A. There is a government safety net supporting Too Big to Fail megabanks.

Conservative policymakers argue that, when it comes to the government-sponsored enterprises – Fannie Mae and Freddie Mac – "[y]ou ought to be either public or private; don't mix up private profit-making opportunities with an institution that is going to be protected by the government but not controlled by it."[2] The same logic applies to the "too big to fail" (TBTF) megabanks that former Federal Reserve Governor Kevin Warsh calls "quasi-public banking utilities."[3]

The largest Wall Street megabanks enjoy protection from a "safety net" – a variety of explicit and implicit guarantees that their profits will be enjoyed by private parties and the costs will be paid by society.[4] Arnold Kling of the CATO Institute argues that "large banks will inevitably have too much power for the apparatus to govern them" and that the power of megabanks subjects the nation to a "regime of private profits and socialized risk."[5] Wall Street megabanks, their shareholders, and their bondholders expect the U.S. government to step in during a crisis and provide capital to keep them in business.

---

[1] *See* Sherrod Brown, *Let's Keep Banks from Growing Too Big to Regulate*, WASH. POST, Apr. 30, 2010.
[2] Gretchen Morgenson, *How Mr. Volcker Would Fix It*, N.Y. TIMES, Oct. 22, 2011 at BU1 (quoting former Federal Reserve Chairman Paul Volcker).
[3] Remarks by Kevin Warsh, Distinguished Visiting Fellow, Hoover Institution Stanford University at the Seventh Annual Morrison & Foerster Lectureship, Stanford, Calif., Apr. 25, 2012 at 1.
[4] *See, e.g.*, Remarks By Paul A. Volcker Before The Statutory Congress Of The European People's Parties, Bonn, Germany, Dec. 9, 2009 ("One consistent response has been to protect and support national commercial banking systems with a combination of regulation and a so-called 'safety net', including deposit insurance and a central bank able and willing to serve as a 'lender of last resort'. The central idea is to provide liquidity to troubled but solvent institutions while protecting individual depositors.").
[5] Arnold Kling, "Break Up the Banks", National Review, Apr. 5, 2010.

Ed Kane of Boston College describes the arrangement between megabanks and the government "as a valuable option – a 'taxpayer put'" that "serves as a substitute for ordinary on-balance-sheet capital supplied by the firm's shareholders."[6] The existence of this "taxpayer put" makes taxpayers the de facto and silent shareholders in our nation's major financial firms.[7] Unlike traditional shareholders, taxpayers only share in the losses not the gains experienced by these megabanks. It also creates what economist Simon Johnson has called "a nontransparent contingent liability for the federal budget in the United States."[8]

According to some experts, the vast majority of liabilities in the U.S. financial system are covered by a safety net that includes underpriced deposit insurance and implicit government guarantees.[9] The sweep of this safety net was expanded during the financial crisis of 2008, when Goldman Sachs and Morgan Stanley converted to bank holding companies, in large part to participate in Federal Reserve programs, including the Federal Reserve's discount window.[10] This development was, "widely interpreted as a clear signal that the federal government would not let either of them fail."[11]

Unfortunately, some continue to believe that the government will continue to support Wall Street megabanks. Credit rating agencies have stated that they will consider the likelihood of government support when determining an institution's credit rating.[12] Federal Reserve Bank of Kansas City President and CEO Esther George says that, "[t]hese ratings advantages continue to exist after the crisis—albeit at a notch or two less now, and investors have reason to believe that similar advantages may yet exist."[13]

B. Governments use this unspoken safety net to bail out TBTF banks during financial crises.

The benefits of the safety net were on display during the financial crisis, with the largest megabanks receiving a disproportionate amount of assistance.

---

[6] Edward J. Kane, "Bankers and Brokers First: Loose Ends in the Theory of Central-Bank Policymaking", Federal Reserve Bank of Chicago, Fourteenth Annual International Banking Conference, Nov. 15, 2011, at 3.
[7] *See id.*, at 8.
[8] Testimony of Simon Johnson, Ronald Kurtz Professor of Entrepreneurship, MIT Sloan School of Management, before the Subcommittee on Financial Institutions and Consumer Protection, Senate Committee on Banking, Housing, and Urban Affairs, hearing on "A New Regime for Regulating Large, Complex Financial Institutions," December 7, 2011 at 2.
[9] *See* Viral V. Acharya, Thomas Cooley, Matthew Richardson & Ingo Walter, *Manufacturing Tail Risk: A Perspective on the Financial Crisis of 2007-09*, 4 Foundations and Trends in Finance 249, 267-269 (2010).
[10] *See* Saule T. Omarova, *From Gramm-Leach-Bliley To Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act*, 89 N.C. L. REV. 1683, 1745-46 (2011).
[11] *Id.*, at 1746.
[12] *See* Standard & Poor's, *The U.S. Government Says Support For Banks Will Be Different "Next Time"—But Will It?*, 9-10 (July, 2011)("Ultimately, in our views of new legislation and regulation, we need to consider the long track-record of extraordinary support that may be essential for a handful of institutions despite government reluctance to offer such support.").
[13] Esther L. George, President and Chief Executive Officer, Federal Reserve Bank of Kansas City, "Looking Ahead: Financial Stability and Microprudential Supervision" 6, Levy Economics Institute of Bard College, 21st Annual Hyman P. Minsky Conference, New York, N.Y., Apr. 11, 2012.

In the last 130 years, U.S. bank assets have grown from 20 percent of GDP to 100 percent of GDP.[14] From 1995 to 2009, the assets of the six largest U.S. banks alone grew from 18 percent to 68 percent of the country's GDP.[15] Unsurprisingly, the IMF reports that the size of an institution relative to its home country GDP or relative to the financial system seems to play a key role in authorities' decisions about whether the bank receives a bailout in the event of distress.[16]

It should therefore come as no surprise that 190 financial firms borrowed $1.2 trillion from the Federal Reserve from 2007 to 2009,[17] with the six biggest U.S. banks borrowing as much as $460 billion and accounting for 63 percent of the average daily debt to the Fed.[18] The same six firms also received $160 billion in TARP funds.[19] According to the Congressional Oversight Panel for TARP (COP), the six largest banks received a total of $1.27 trillion in government support.[20]

According to the Federal Reserve Bank of Dallas, "dealing with TBTF financial institutions necessitates quasi-nationalization of a private company, a process antithetical to a capitalist system."[21] Thomas Hoenig, a member of the Federal Deposit Insurance Corporation, agrees that this arrangement is "[f]undamentally inconsistent with capitalism."[22]

III. Government Support Provides TBTF Banks with Important Subsidies

Speaking about the phenomenon of "too big to fail" megabanks, Simon Johnson said: "[t]his is not a market; it is a large-scale, nontransparent, and unfair government subsidy scheme."[23]

The implicit – and in some cases explicit – taxpayer-funded safety net provides subsidies to the financial industry that are not enjoyed by other industries. One study comparing baskets of bank equities options with non-financial companies calculated that the government's

---

[14] *See* Andrew Haldane, Simon Brennan & Vasileios Madouros, "What is the Contribution of the Financial Sector: Miracle Or Mirage?", THE FUTURE OF FINANCE: THE LSE REPORT (2010) at 98.
[15] *See* Simon Johnson & James Kwak, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 203 (Pantheon, 2010).
[16] *See* İnci Ötker-Robe, Aditya Narain, Anna Ilyina, & Jay Surti, *The Too-Important-to-Fail Conundrum: Impossible to Ignore and Difficult to Resolve*, IMF SDN/11/12, May 27, 2011, at 8.
[17] *See* Bob Ivry, Bradley Keoun & Phil Kuntz, *Secret Fed Loans Gave Banks Undisclosed $13B*, BLOOMBERG, Nov. 27, 2011 available at http://www.bloomberg.com/news/2011-11-28/secret-fed-loans-undisclosed-to-congress-gave-banks-13-billion-in-income.html.
[18] *See id.*
[19] *See id.*
[20] *See* Congressional Oversight Panel, *March Oversight Report: The Final Report of the Congressional Oversight Panel* 36 (Mar. 2011).
[21] Harvey Rosenblum, "Choosing the Road to Prosperity: Why We Must End Too Big to Fail—Now" 10, Federal Reserve Bank of Dallas 2011 Annual Report.
[22] Thomas M. Hoenig, President and Chief Executive Officer, Federal Reserve Bank of Kansas City, "Do SIFIs Have a Future?" 4, Pew Financial Reform Project and New York University Stern School of Business, "Dodd-Frank One Year On", Washington, D.C., June 27, 2011.
[23] Johnson, *supra*.

downside protection for the financial sector lowers the industry's equity risk premium by 50 percent and accounts for half of the value of the financial sector.[24]

A. *Government support allows TBTF Megabanks to borrow more cheaply than community banks.*

According to the Dallas Fed, "TBTF banks' sheer size and their presumed guarantee of government help in time of crisis have provided a significant edge—perhaps a percentage point or more—in the cost of raising funds."[25]

Government support provides a boost to their credit ratings—ranging from 1-3 notches in the case of five of the six largest banks.[26] These largest banks are able to borrow more cheaply than they otherwise would, based upon their risk profiles.[27] The IMF estimates that banks larger than $100 billion have about a 50 basis points (bps) funding advantage over banks in the $10-100 billion range.[28] Studies have demonstrated that banks are willing to pay a premium to cross the $100 billion threshold that some view as the "too big to fail" line.[29]

The *Wall Street Journal* editorial board noted that, in 2010, "[t]he funding advantage enjoyed by banks with more than $100 billion in assets over those in the $10-$100 billion range rose from 71 basis points in the first quarter to 78 basis points in the third quarter ... The advantage increased to 81 in the fourth quarter."[30]

Several studies have sought to calculate the precise borrowing advantages enjoyed by the largest banks:

- Andy Haldane, of the Bank of England, estimates that the average annual subsidy for the top five banks in the world between 2007 and 2009 was about $60 billion per year.[31]

---

[24] *See* Bryan T. Kelly, Hanno Lustig & Stijn Van Nieuwerburgh, *Too-Systemic-To-Fail: What Option Markets Imply About Sector-Wide Government Guarantees*, NBER Working Paper 17149 (July 2011) at 5.
[25] Rosenblum, *supra*, at 17.
[26] *See* Susanne Craig & Peter Eavis, *Three Major Banks Prepare for Possible Credit Downgrades*, N.Y. TIMES DEALBOOK, Mar. 29, 2012, *available at* http://dealbook.nytimes.com/2012/03/29/three-major-banks-prepare-for-possible-credit-downgrades.
[27] *See* Anat R. Admati, Peter M. DeMarzo, Martin F. Hellwig & Paul Pfleiderer, *Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is Not Expensive*, Stanford University Working Paper No. 86 (Mar. 2011) at 22.
[28] *See* Ötker-Robe, Narain, Ilyina, & Surti, *supra*, at 6, Figure 1.
[29] *See* Elijah Brewer III & Julapa Jagtiani, *How Much Did Banks Pay To Become Too-Big-To-Fail And To Become Systemically Important?*, Federal Reserve Bank of Philadelphia Working Paper No. 09-34 (2009) at 36-37 ("We find that banking organizations are willing to pay an added premium for mergers that will put them over a TBTF threshold. This added premium amounted to an estimated $14 billion to $17 billion extra that eight banking organizations in our data set were willing to pay for acquisitions that enabled them to become TBTF (crossing the $100 billion book value of total assets threshold).").
[30] Review & Outlook, *Still Too Big, Still Can't Fail*, WALL ST. J. (Mar. 5, 2011).
[31] *See* Andrew G. Haldane, Executive Director, Financial Stability, Bank of England, "The $100 Billion Question", Comments at the Institute of Regulation & Risk, Hong Kong, Mar. 30, 2010 at 5.

- The IMF has estimated that government support provides "too big to fail" institutions with a funding benefit between 10 and 50 bps, with an average of about 20 bps.[32]

- Kane and his colleagues estimate that "too big to fail" banks receive a safety net subsidy between 10 and 22 bps per dollar of assets, and also show more leverage.[33]

- Deniz Anginer and Joseph Warburton find that large banks had an annual funding cost advantage of approximately 16 bps before the financial crisis, increasing to 88 bps during the crisis, and peaking at more than 100 bps in 2008.[34] They estimate the total value of the implicit government subsidy at about $4 billion per year before the financial crisis, $60 billion during the crisis, and a high of $84 billion in 2008.[35]

- Dean Baker and Travis MacArthur estimate that, at the time of the financial crisis, banks with assets in excess of $100 billion had an average borrowing advantage of 78 bps, implying a subsidy of $34.1 billion a year.[36]

- Some estimate that implicit governmental guarantees provide a subsidy of 3.10 percent per year to the cost of equity capital for the largest banks, and impose a 3.25 percent tax on the smallest banks, amounting to an annual subsidy of $4.71 billion per bank.[37] And that doubling the size of market capitalization provides a bank with a subsidy of 68 bps.[38]

This government-supplied advantage hurts community banks. In April 2011, Paul Reed of Farmers Bank in Pomeroy, OH, told the Subcommittee on Financial Institutions and Consumer Protection: "For years I faced funding costs higher than the largest financial institutions because the marketplace knew they were guaranteed against failure."[39]

According to Mr. Reed, "While we all supported ending too big to fail, the market suggests we have not done so."[40]

---

[32] International Monetary Fund, *A Fair And Substantial Contribution By The Financial Sector: Final Report For The G-20*, June 2010, at 55-56.
[33] *See* Santiago Carbo-Valverde, Edward J. Kane & Francisco Rodriguez-Fernandez, *Safety-Net Benefits Conferred On Difficult-To-Fail-And-Unwind Banks In The US And EU Before And During The Great Recession*, Paolo Baffi Centre Research Paper Series No. 2011-95, at 9-10.
[34] *See* A. Joseph Warburton & Deniz Anginer, "The End of Market Discipline? Investor Expectations of Implicit State Guarantees" 4 (Nov. 18, 2011), *available at* http://ssrn.com/abstract=1961656.
[35] *See id.*
[36] *See* Dean Baker & Travis MacArthur, *The Value of the "Too Big to Fail" Big Bank Subsidy*, Center for Economic and Policy Research (2009).
[37] *See* Priyank Gandhi & Hanno Lustig, *Size Anomalies in U.S. Bank Stock Returns: A Fiscal Explanation*, NBER Working Paper 16553 (2010) at 5.
[38] *See id.*, at 26 ("[A] 100% increase in the size of market cap relative to GDP … increases the subsidy by 68 bps per annum.").
[39] Testimony of Paul Reed, Chairman of the Ohio Bankers League, and President and Chief Executive Officer of the Farmers Bank and Savings Company, Before United States Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on Financial Institutions and Consumer Protection, April 6, 2011 at 3.
[40] *Id.*

B. Government support makes other financial transactions cheaper for TBTF megabanks.

The credit rating bump resulting from government support does not just allow TBTF megabanks to borrow at lower rates. This boost also results in more favorable terms for their financial contracts, including posting less margin behind their deals.

Support – such as FDIC deposit insurance – also provides certain bank subsidiaries with higher ratings that can encourage institutions to shift their risk to these subsidiaries. For example, Bank of America moved $15 trillion in derivatives contracts from its broker-dealer, Merrill Lynch, to its insured depository institution affiliate in response to a credit downgrade. The result is that taxpayers would subsidize, and ultimately backstop, potentially risky investments. This move reportedly saved the bank $3.3 billion in additional collateral payments.[41]

When the Federal Reserve granted a 23A exemption to Goldman Sachs Bank in 2009, Goldman moved its multi-purpose derivatives dealer into its insured bank affiliate. Likewise, Morgan Stanley converted to a bank holding company, and received a 23A exemption for its derivatives business. And JPMorgan Chase Bank, N.A., currently holds 99 percent of the notional derivatives of JPMorgan Chase & Co.[42]

Morgan Stanley is reportedly considering similar measures in response to a threatened downgrade by Moody's.[43] Such a downgrade could require Morgan Stanley to post as much as $6.5 billion over the course of a year.[44]

These actions continue a trend of decisions by the Federal Reserve to exempt insured banks from Section 23A of the Federal Reserve Act, and extend the safety net of bank holding companies to repurchase agreements, or "repos," and derivative dealing activities.[45]

C. Government support enables TBTF megabanks to be riskier than community banks.

Traditionally, corporations make financial decisions under threat of bankruptcy – if they miss mandatory interest payments on their bonds, their creditors can force them into restructuring or insolvency.[46]

---

[41] *See* Bob Ivry, Hugh Son & Christine Harper, *BofA Said to Split Regulators Over Moving Merrill Derivatives to Bank Unit*, BLOOMBERG, Oct. 18, 2011 *available at:* http://www.bloomberg.com/news/2011-10-18/bofa-said-to-split-regulators-over-moving-merrill-derivatives-to-bank-unit.html. Moody's is reportedly considering cutting Bank of America's rating further, requiring up to $4.5 billion in additional cash and collateral. *See* Craig & Eavis, *supra.*

[42] *See* Office of the Comptroller of the Currency, OCC's Quarterly Report on Bank Trading and Derivatives Activities Second Quarter 2011, at Table 1, Table 2.

[43] *See* Tracy Alloway, *Morgan Stanley Tries to Stave off Ratings Cut*, FINANCIAL TIMES, Apr. 5, 2012, *available at* http://www.ft.com/intl/cms/s/0/99979138-7e67-11e1-b20a-00144feab49a.html#axzz1rAjV9Gao.

[44] *See* Craig & Eavis, *supra*.

[45] *See* Omarova, 89 N.C. L. REV. at 1735-41; *see also id.*, at 1745-50. Professor Saule Omarova has argued that, "the Board dismantled the entire section 23A regime in order to make an emergency transfusion of the federal subsidy into the shadow banking system." *Id.*, at 1690.

[46] *See* Fleischer, *supra*, at 6.

The safety net encourages institutions to engage in riskier activities – increasing leverage and investments in riskier assets – because someone else (in this case, the taxpayer) will bear the loss.[47] It also encourages executives to extract bonuses and dividends that would otherwise be used to ensure that their banks have enough equity to pay their obligations when they hit a rough patch.[48]

Thomas Hoenig, a member of the Board of the Federal Deposit Insurance Corporation and former President of the Kansas City Federal Reserve, has noted that the government safety net allows large banks to be undercapitalized relative to their community bank competition. In 2009, the 20 largest financial institutions on average fund themselves with a mix of 3.5 percent equity capital, as compared to an equity capital ratio of 6 percent held by the second tier of institutions.[49]

This undercapitalization gives megabanks a financial advantage over their community bank competitors. Were the largest banks to meet the 6 percent benchmark, they would be forced to raise $300 billion in capital, shrink their balance sheets by $5 trillion, or some combination thereof.[50]

And megabanks are even riskier after the financial crisis and ensuing bailout. A recent discussion paper by Federal Reserve staff concludes the degree of risk in commercial loans made by TARP recipients appears to have increased for large banks but decreased for small banks.[51]

D. Bailouts provide gifts to TBTF megabanks and impose costs on community banks.

Commentators have noted that a loan to an underwater bank is akin to a "long-shot equity investment whose substantial downside easily justifies a 15% to 20% return."[52] Such loan rates are comparable with risky sovereign bond yields. But the Fed's emergency lending is never that stringent. For example, the Federal Reserve's Term Auction Facility maxed out at an interest rate of 4.67 percent.[53] The result is that these foundering banks can borrow money far more cheaply than the market would bear.

Comparing net interest margins for these loans and the loans made by banks, *Bloomberg* estimates that the terms of the Fed's loans yielded borrowing firms a profit of $13 billion.[54] *Bloomberg* estimates that the six largest banks made $4.8 billion in profit from these loans–equal to 23 percent of their combined net income during those two years.[55]

---

[47] *See* Johnson & Kwak, *supra*, at 151; *see also* Carbo-Valverde, Kane & Rodriguez-Fernandez, *supra*.
[48] *See* Kane, *supra*.
[49] *See* Thomas M. Hoenig, "Leverage and Debt: The Impact of Today's Choices on Tomorrow", speech delivered to the Kansas Bankers Association 2009 Annual Meeting (Aug. 6, 2009) at 2.
[50] *See id.*, at 3.
[51] *See* Lamont Black & Lieu Hazelwood, "The Effect of TARP on Bank Risk-Taking" 19, Board of Governors of the Federal Reserve System International Finance Discussion Paper #1043, Mar. 2012.
[52] *See* Kane, *supra*, at 6.
[53] *See* Board of Governors of the Federal Reserve, Term Auction Facility Data, available at http://www.federalreserve.gov/newsevents/files/taf.xls.
[54] *See* Ivry, Keoun & Kuntz *supra*.
[55] *See id.*

TARP also provided megabanks with significant benefits. The COP concluded that "Treasury paid substantially more for the assets it purchased under the TARP than their then-current market value."[56] This provided the six biggest megabanks with a subsidy of $25 billion.[57]

In addition to taxpayers, smaller banks are often asked to pay for the failure of large banks through assessments contributing to the FDIC's Depository Insurance Fund. In 2000, the FDIC noted that the costs of "systemic risk" bailouts fall "in part on the vast majority of smaller banks for whom it is virtually inconceivable that they would receive similar treatment if distressed."[58]

IV. TBTF Banks are Even Bigger Now

Overwhelming size and outsized market power can both increase financial instability and result in inflated prices for clients and consumers.[59] Notwithstanding the difficulties posed by the financial crisis, the size of our largest banks has only grown – sometimes at the behest of the federal government.

The Dallas Fed says that "huge institutions still dominate the industry—just as they did in 2008."[60] The principle method by which the Treasury Department and the New York Federal Reserve attempted to avoid financial crisis in 2008 was to arrange mergers between failing institutions and their megabank competitors.[61] As a result of mergers, three of the four largest megabanks grew by an average of more than $500 billion.[62]

Bloomberg estimates that the banking sector grew seven times faster than gross domestic product from the beginning of the financial crisis to the end of 2010.[63] In 2006, before the financial crisis, the top 10 banks held 68 percent of total bank assets.[64] By the end of 2010, they held 77 percent of total banking assets.[65] Furthermore, the six largest banks now have liabilities

---

[56] *See* Congressional Oversight Panel, *supra*, at 39.
[57] *See id*.
[58] FED. DEPOSIT INS. CORP., OPTIONS PAPER, AUG. 2000, at 33, available at http://www.fdic.gov/deposit/insurance/initiative/Options_080700m.pdf.
[59] *See* Financial Stability Oversight Council, Study of the Effects of Size and Complexity of Financial Institutions on Capital Market Efficiency and Economic Growth (2011) *at* 11-12.
[60] Rosenblum, *supra*, at 21.
[61] *See* Andrew Ross Sorkin, TOO BIG TO FAIL 459 (Penguin Books, 2010) ("On a pad that morning, [Federal Reserve Bank of New York President Timothy] Geithner started writing out various merger permutations: Morgan Stanley and Citigroup. Morgan Stanley and JP Morgan Chase. Morgan Stanley and Mitsubishi. Morgan Stanley and CIC. Morgan Stanley and Outside Investor. Goldman Sachs and Citigroup. Goldman Sachs and Wachovia. Goldman Sachs and Outside Investor. Fortress Goldman. Fortress Morgan Stanley. It was the ultimate Wall Street chessboard.").
[62] *See* Johnson & Kwak, *supra*, at 180.
[63] *See* Cady North, *Too-Big-to-Fail Banks Get Bigger After Dodd-Frank*, BLOOMBERG GOVERNMENT (Mar. 2011) *at* 3.
[64] *See id.*, at 10.
[65] *See id.*

totaling roughly 57.1 percent of our nation's total economic output.[66] These six banks combined are now twice as large as the rest of the top 50 U.S. banks combined.[67]

In 1999, conservative columnist William Safire said, "[s]heer size rules. We look to government either to regulate monopoly or enforce competition. But as we have deregulated to let the free market operate, government has failed to enforce antitrust laws to maintain competition in media and now in money."[68] Unfortunately for U.S. consumers and taxpayers, the situation has only gotten worse, as the six largest Wall Street megabanks continue to enjoy outsized profits and the banking industry continues to be excessively concentrated.

According to Robert Wilmers, the CEO of M&T Bank:

- As of September 30, 2010, the six biggest banks accounted for 35 percent of all U.S. deposits and 53 percent of all banking assets;[69]

- In 2010, the trading revenues of these six institutions represented 93.1 percent of such revenues at all American banks;[70] and

- Today, the six largest banks service roughly 56 percent of all mortgages, and nearly two-thirds of the mortgages in foreclosure.[71]

This level of concentration should be opposed by supporters of truly free markets. As Dr. Tom Coburn has said, "[c]apitalism works as long as you don't have monopolies, and when 65 percent of the deposits in this country are in nine banks, we're still in trouble."[72]

V. It is Time to Shrink the TBTF Megabanks.

The first step to preventing another crisis and recapturing unfair subsidies is to require megabanks to start by funding themselves the same way that community banks do: by issuing more equity and taking on less debt. This way more of their own money is on the line when they get themselves into trouble.

But these megabanks must also be contained. As noted above, outsized market power reduces competition and inflates prices for clients and consumers. Making Wall Street banks smaller and simpler will benefit taxpayers by recapturing unnecessary government subsidies and preventing future bailouts. It will improve pricing and service.

---

[66] Calculation based upon FFIEC data for the six largest bank holding companies by assets.
[67] Calculation based upon FFIEC data, excluding assets of Metlife.
[68] William Safire, *Running Huge Risks*, N.Y. TIMES, Nov. 01, 1999.
[69] *See* Robert G. Wilmers, 2010 Annual Report to Shareholders, February 18, 2011 *available at* http://mtb.mediaroom.com/2010message.
[70] *See id.*
[71] *See* Robert G. Wilmers, 2011 Annual Report to Shareholders, February 23, 2012 *available at* http://mtb.mediaroom.com/2011message.
[72] Ross Douthat, *A Serious Man*, N.Y. TIMES, Dec. 13, 2010, at A25.

It will also make megabanks more transparent. Federal Reserve Bank of Kansas City President Esther George says that, "[t]he expansion in activities conducted by banking organizations over the past few decades has greatly increased the level of complexity in such organizations, making effective management and supervision of these entities much more difficult."[73] The Federal Reserve Bank of Kansas City estimates that it would require 70,000 examiners to study a trillion-dollar bank with the same level of scrutiny as a community bank.[74] And former executives have admitted that it is impossible to fully understand all of the positions that trillion-dollar megabanks are taking.[75]

Making banks more transparent and less risky will increase shareholder value. Presently, many megabanks are trading well below their book values. As former Federal Reserve Chairman Alan Greenspan once argued, "[i]n 1911 we broke up Standard Oil – so what happened? The individual parts became more valuable than the whole."[76] Former FDIC Chairman Sheila Bair estimates that shareholders of the three largest banks would see anywhere from $52 billion to $270 billion in appreciation if those institutions were to be divided into smaller – though still large – institutions.[77] In May 2010, analysts at Goldman Sachs estimated that the "break-up" values of the two largest U.S. banks would have been higher than their stock prices at the time.[78]

If this approach appears to be radical, consider the suggestions of the following experts:

- Paul Volcker, Former Chairman of the Board of Governors of the Federal Reserve: "[T]he risk of failure of 'large, interconnected firms' must be reduced, whether by reducing their size, curtailing their interconnections, or limiting their activities."[79]

- Sheila Bair, Former Chairman of the Federal Deposit Insurance Corporation: "It would surely be in the government's interest to downsize megabanks… The public-policy benefits of smaller, simpler banks are clear."[80]

- Richard Fisher, President and CEO of the Federal Reserve Bank of Dallas: "But giant banks, operating on the belief that they are backed by government, turn these

---

[73] George, *supra*, at 8.
[74] *See* Yalman Onaran, ZOMBIE BANKS: HOW BROKEN BANKS AND DEBTOR NATIONS ARE CRIPPLING THE GLOBAL ECONOMY 3 (Bloomberg Press, 2012).
[75] *See* Cheyenne Hopkins, *No One Was Sleeping as Citi Slipped*, AM. BANKER, Apr. 8, 2010 ("'There isn't a way for an institution with hundreds of thousands of transactions a day involving something over a trillion dollars that you are going to know what's in those position books,' Rubin said. 'I didn't know it when I was at Goldman Sachs and you wouldn't know it on the board of Citi either. You rely on the people there to bring you problems when they exist.'") *available at:* http://www.americanbanker.com/issues/175_67/citi-1017353-1.html.
[76] Michael McKee & Scott Lanman, *Greenspan Says U.S. Should Consider Breaking Up Large Banks*, BLOOMBERG, Oct. 15, 2009 *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aJ8HPmNUfchg.
[77] *See* Sheila Bair, "Why It's Time to Break Up the 'Too Big to Fail' Banks", FORTUNE MAGAZINE, Feb. 6, 2012.
[78] *See* Richard Ramsden, Alec Phillips, Brian Foran & Daniel Harris, US Banks: Regulation 32, The Goldman Sachs Group, Inc., May 2010.
[79] Paul A. Volcker, The William Taylor Memorial Lecture, "Three Years Later: Unfinished Business In Financial Reform", Washington, D.C., Sept. 23, 2011.
[80] Bair, *supra*.

otherwise manageable episodes into catastrophes. Is there a better alternative? Yes, reducing the size and complexity of the largest banks."[81]

- Thomas Hoenig, member of the Board of the FDIC and former President of the Kansas City Federal Reserve: "An often heard statement by many policymakers and financial market experts over the past couple of years has been that if a financial firm is too big to fail, then it is too big. I couldn't agree more."[82]

Community banks understand that the present system puts them at a disadvantage. Cam Fine, President and CEO of the Independent Community Bankers of America said recently: "[d]ownsizing too-big-to-fail institutions and the risks they pose to the financial system could not be worse than taxpayers spending trillions of dollars propping up these firms and federal officials, not the free market, picking winners and losers."[83]

This proposal will ensure that success is based upon genuine competition, not taxpayer subsidies. Arnold Kling says that there is a "free-market case for breaking up large financial institutions: that our big banks are the product, not of economics, but of politics."[84] Former Federal Reserve Governor Warsh says that "[w]e cannot have a durable, competitive dynamic banking system that facilitates economic growth if policy protects the franchises of oligopolies atop the financial sector."[85] Warren Stephens of financial firm Stephens, Inc., similarly wrote in the *Wall Street Journal*: "[w]e should promote competition and innovation in the financial industry, not protect an oligopoly."[86]

The statements of these financial experts demonstrate that the need for the SAFE Banking Act, and similar proposals, remains strong.

---

[81] Richard W. Fisher & Harvey Rosenblum, *How Huge Banks Threaten the Economy*, WALL ST. J., Apr. 4, 2012 at A15.
[82] Thomas M. Hoenig, "The Financial Foundation for Main Street" 7, Speech before the U.S. Chamber of Commerce Center for Capital Markets Competitiveness, Capital Markets Summit: Getting Main Street Back to Work, Washington, D.C., Mar. 24, 2010.
[83] Cam Fine, *Break Up the Megabanks? We Could Do a Lot Worse*, AM. BANKER, Apr. 17, 2012 available at: http://www.americanbanker.com/bankthink/Breaking-Up-Too-Big-To-Fail-1048457-1.html
[84] Kling, *supra*.
[85] Warsh, *supra*.
[86] Warren A. Stephens, *How Big Banks Threaten Our Economy*, WALL ST. J., Apr. 30, 2012.